

Docket No.: 10-0280
Bench Date: 12/15/10
Deadline: 2/1/11

MEMORANDUM

TO: The Commission

FROM: Bonita A. Benn,
Administrative Law Judge

DATE: December 6, 2010

SUBJECT: Galena Territory Utilities, Inc.

Proposed general increase in water and sewer rates. (tariffs filed March 5, 2010)

RECOMMENDATION: Enter Order reflecting the increase in water and sewer rates.

Chronology

On March 5, 2010, Galena Territory Utilities Inc. ("GTUI" or the "Company") filed revised tariff sheets in which it proposed a general increase in water and sewer rates to become effective April 19, 2010. The tariff sheets, hereinafter referred to as its "Filed Rate Schedule Sheets," were identified as Ill. C. C. No. 1, Fourth Revised Sheet No. 1, and Ill. C. C. No. 3, Fifth Revised Sheet No. 1.

On April 7, 2010, the Commission entered an Order suspending the Filed Rate Schedule Sheets up to and including August 1, 2010. On July 28, 2010, the Commission resuspended the Filed Rate Schedule Sheets up to and including February 1, 2011.

Notice of the proposed increase in water and sewer rates was posted and published in a newspaper of general circulation throughout the Company's service area in accordance with the requirements of Section 9-201 of the Public Utilities Act ("Act") and the provisions of 83 Ill. Adm. Code Sec. 255. Notice of the filing was also sent to GTUI customers with the first billing after the filing.

Leave to Intervene was granted to The Galena Territory Association, Inc. ("Intervenor" or "Property Owners Association".)

Pursuant to notice as required by the law and the rules and regulations of the Commission, a hearing was scheduled in this matter before a duly authorized Administrative Law Judge ("ALJ") of the Commission at its offices in Chicago, Illinois, on September 15, 2010. Prior to hearing, the Company, Intervenor and Staff advised the Administrative Law Judge that they had entered into a stipulation whereby all parties would not object to the admission into evidence of all pre-filed testimony, waive cross-examination, and agreed to present to the ALJ a proposed order in which the Parties

would agree to certain issues being resolved based upon Staff's proposed changes. As a result of the Stipulation, the Company offered the testimony of Dmitry Neyzelman, Regulatory Accountant for Utilities, Inc. ("UI") and its subsidiaries, including GTUI. Staff offered the testimony of the following witnesses: Phillip Rukosuev of the Rates Department, Financial Analysis Division; William R. Johnson of the Water Department, Financial Analysis Division; Mike Ostrander and Burma C. Jones of the Accounting Department, Financial Analysis Division; and Janis Freetly of the Finance Department, Financial Analysis Division. Intervenor offered the testimony of Joe Mattingley, General Manager of The Galena Territory Association, Elizabeth Pryse Mitchell, a resident in the Galena Territory community; and Scott J. Rubin, an independent consultant and attorney. As agreed, all parties waived cross-examination.

Pursuant to the Stipulation, the Parties agree that the Revenue Requirement Schedules and adjustment Schedules that are described in and accompany ICC Staff Ex. 11.0, and the water and sewer rates set forth in ICC Staff Ex. 12.0, Schedules 12.1 and 12.2, should be adopted by the Commission. The Stipulation further provides that for purposes of this Docket only that all other outstanding issues have been fully resolved and that no conditions, limitation or requirements shall be adopted or imposed upon any of the parties other than those that the record show were recommended by Staff and accepted by the Company. The Parties acknowledged that any resolution of issues raised in the case that is implicit within the agreed-upon revenue requirements and rates is agreed for purposes of settlement of this case only in order to conserve resources and reduce uncertainty, and would not bind the Parties in any future consideration of the issues. The Parties waived the filing of post-trial briefs. The Company prepared a Draft Order to which Staff and the Property Owners Association, after reviewing it and suggesting revisions which were incorporated, stated that they had no objection to the entry of an Order incorporating the language of the Draft Order.

GTUI provides water and sewer service to approximately 2,200 water customers and 800 sewer customers in Jo Daviess County, Illinois. GTUI is a wholly-owned subsidiary of UI, which owns and operates water and/or wastewater systems throughout the United States. Water Service Corporation ("WSC") manages the operations for all of UI's water and sewer systems, including GTUI's water and sewer systems. WSC provides management, administration, engineering, accounting, billing, data processing, and regulatory services for the utility systems.

GTUI's filing is based on a historical test year ending December 31, 2008, with *pro forma* adjustments for known and measurable changes. No party contested the reasonableness of using 2008 as the test year.

In its direct testimony, the Company valued its original cost water and sewer rate bases at \$3,374,176 and \$477,061, respectively, after making *pro forma* adjustments to its original cost rate base for the test year ending December 31, 2008. Galena Territory Association, Inc. proposed reducing the water rate base by \$178,149 and the sewer rate base by \$72,796 to eliminate the allocation by UI to the Company for UI's new accounting and customer service computer systems. This adjustment also would decrease water depreciation expenses by \$25,457 and sewer depreciation expenses by \$10,403. Staff proposed various adjustments to the Company's *pro forma* rate base, including adjustments to plant in service, accumulated depreciation, deferred charges

and working capital. Staff proposed no adjustments to eliminate the allocation for the new accounting and customer service computer systems. Staff's recommended adjustments are reflected in Appendix A - Water and Appendix B – Sewer and the final rate base is \$3,218,435 for water and \$432,320 for sewer respectively. The Order adopts the Stipulation and finds that the proposed water and sewer depreciation rates are reasonable and should be approved. The Order also finds that the adjustments to the rate base proposed in Staff's exhibits are supported by the evidence, are reasonable, and should be adopted.

In its direct testimony, the Company's reported net operating income of \$303,563 for water and \$42,920 for sewer resulting in a revenue change of \$69,787 and \$443,225. Staff proposed various adjustments to GTUI's *pro forma* operating statements. Staff's adjustments are also reflected in Appendix A – Water and Appendix B – Sewer. The Order concludes the adjustments to operating revenues, expenses (including taxes) and utility operating income are reasonable, and should be adopted. The reconciliation of operating expenses for the test year ended December 31, 2008 is \$33,677 for sewer and \$250,716 for water, yielding a total revenue change of \$289,057.

Since GTUI, is a wholly owned subsidiary of Utilities, Inc., Staff proposed using Utilities, Inc.'s capital structure for the year ending December 31, 2008. Staff estimated a short term debt ratio of 6.24%, long term debt ratio of 49.81%, and common equity ratio of 43.96%. The embedded cost of short term debt is estimated at 2.64% and 6.65% for long term debt. Finally, Staff recommended the cost of common equity for Galena Territory Utilities to be set at 9.82%. Staff measured the investor-required rate of return for UI with the discounted cash flow ("DCF") and risk premium models. DCF and risk premium models cannot be directly applied to UI because its stock is not market-traded. Therefore, Staff applied those models to water utility and public utility samples deemed comparable in risk to GTUI.

Staff estimated the investor-required rate of return on common equity for the water sample of 9.51% by taking the simple average of the DCF-derived results (9.61%) and the risk-premium derived results (9.41%) for the water sample. Staff estimated the investor-required rate of return on common equity for the utility sample of 10.12% by taking the simple average of the DCF-derived results (10.83%) and the risk-premium derived results (9.41%) for the utility sample. The investor required rate of return on common equity for GTUI, 9.82%, is based on the average for the water and utility samples. The Order finds the Stipulation reasonable and concludes the Company's cost of equity capital is 9.82% and its overall cost of capital is 7.79%

The Company's present water rate structure consists of a minimum monthly charge that is billed quarterly and includes the first 3,000 gallons of usage and a single block usage charge per 1,000 gallons for all additional usage. The Company proposed to replace the current minimum bill structure with a separate Base Facilities Charge based on American Water Works Association meter factors and a single block usage charge that covers all water consumption and to switch from the current quarterly billing cycle to a monthly billing cycle. Staff found the Company's rate design proposal reasonable, but recommended the Commission set the rates based upon Staff's proposed revenue requirement, by multiplying the Company's proposed customer and usage charges by the ratio of Staff's proposed revenue requirement to the Company's proposed revenue

requirement across-the-board. After an adjustment in response to an Intervenor data request, Staff provided revised proposed water rates that reduced the usage charge and recommended that the Commission approve the Company's proposed monthly billing cycle.

For sewer rates, Staff accepted the current flat fee rate structure utilized by the Company. Staff's proposed sewer rate design included a separate sewer rate for customers using less than 1,000 gallons of water in a billing period, which was based upon the Company's proposed discount methodology and incorporated Staff's revised revenue requirement. Staff recommended approval of its proposed low usage rate for the Company to comply with the requirement of Section 8-306(h) of the Public Utilities Act to establish a sewer rate applicable to customers who use less than 1,000 gallons of water in any billing period. The Order finds the development and design of the rates in the manner recommended by the Stipulation incorporating Staff's recommendations are reasonable and should be accepted.

For miscellaneous fees and charges, the order establishes an After-Hours Call-Out charge of a minimum rate of \$106, equivalent to two hours at the current labor rate of \$53 per hour; an increase to reconnection charges for \$7 to \$37.50 to recover the current average cost of labor per hour for employee time; an increased in Non-Sufficient Funds charges from \$5 to \$25; and an increase in new service application charges from \$12 to \$25. The Order finds these charges to be reasonable and should be approved.

The Order finds the rate design principles and cost-of-service methodologies proposed in Staff's testimony, and the development and design of the rates in the manner proposed by Staff are reasonable. In addition, the Order concludes that the Stipulation incorporating Staff's proposed rates are reasonable and should be approved for GTUI. We conclude, therefore, that they should be adopted.

I recommend that the Commission adopt the attached Order reflecting the increases in Galena Territory Utilities, Inc.'s water and sewer service rates.

BAB:jt